

Original Paper

A New Round of Fiscal and Tax Reform: A Discussion on Implementing Uniform Taxation on Labor Income

Dan Zhao

Department of Accounting, Southwest Jiaotong University Hope College, Chengdu, Sichuan 610400,
China

Received: August 12, 2024 Accepted: September 15, 2024 Online Published: September 28, 2024
doi:10.22158/jepf.v10n4p20 URL: <http://dx.doi.org/10.22158/jepf.v10n4p20>

Abstract

The "Decision on Further Deepening Comprehensive Reforms and Accelerating the Process of Chinese-style Modernization," which was smoothly reviewed and approved at the government conference, "Improving the personal income tax system that combines comprehensive and categorical taxation... and implementing uniform taxation on labor income." This clarifies the direction of personal income tax reform. Based on an analysis and comparison of tax burdens and tax base data for different tax items of personal income tax from 2018 to 2022, this article finds significant differences in tax burdens between business income and other labor income. It analyzes the necessity of implementing uniform taxation on labor income from the principles of tax fairness and tax efficiency and, on this basis, discusses the reform direction and proposes suggestions.

Keywords

Personal income tax, Labor income, Tax burden, Tax reform

1. Introduction

On July 21, 2024, the government smoothly reviewed and approved the "Decision on Further Deepening Comprehensive Reforms and Accelerating the Process of Chinese-style Modernization" (hereinafter referred to as the "Decision"). In terms of personal income tax system reform, the "Decision" proposes, "Improving the personal income tax system that combines comprehensive and categorical taxation, standardizing tax policies for business income, capital income, and property income, and implementing uniform taxation on labor income." This points out a clear direction for the new round of personal income tax reform. However, the "Decision" does not provide further explanation on the meaning of "uniform taxation on labor income." Starting from the current status of

the personal income tax system, this article analyzes the tax burdens of different labor income, and based on the principles of tax fairness and tax efficiency, puts forward suggestions for reform.

2. Current Status of Personal Income Tax Reform

The *"Tax Dictionary"* published by Liaoning People's Publishing House in 1991 defines labor income as *"income obtained through labor that creates value and use value."* It is the income obtained through the exchange of value and use value created by labor. Thus, "labor" is a necessary condition for obtaining labor income. The definition of business income is mainly based on the current tax law. According to Article 6 of the *"Regulations for the Implementation of the Individual Income Tax Law of the People's Republic of China,"* business income mainly refers to the income obtained by individuals, individual business enterprises, and individual investors of partnership enterprises from engaging in production and business activities. Based on the definition of labor income and the current academic views in fiscal and taxation, it can be considered that "business income" in the current tax law belongs to labor income.

After the 2018 tax reform, China's personal income tax system shifted from a classified collection model to a combined comprehensive and classified collection model. The new collection model plays a more significant role in fairing income distribution and narrowing the wealth gap. Currently, there are 11 tax items for personal income tax, which can be roughly divided into two categories: property income and labor income. According to the previous definition, the four types of income that have been included in comprehensive collection belong to labor income, and have been included in the scope of comprehensive collection. In addition, property lease income, property transfer income, and other types of property income belong to the scope of categorical collection. However, besides that, business income has the dual attributes of labor income and capital income. After the "Decision" proposed "uniform taxation on labor income," experts and scholars in the fiscal and taxation circles focused their attention on the reform of the collection method for business income.

3. Analysis of Personal Income Tax Revenue

Tax burden refers to the economic burden borne by taxpayers due to state taxation within a certain period, which can be divided into absolute tax burden and relative tax burden. Absolute tax burden refers to the amount of tax paid by taxpayers, while relative tax burden is expressed in the form of a ratio, which is the ratio of the taxpayer's taxable amount to the value of its taxable object.

According to the classification of income sources by the National Bureau of Statistics, income is divided into wage income, net business income, net property income, and net transfer income. Comparing the personal income tax items, "wage income" and "business income" correspond to the "wage and salary income" and "business income (caliber 1)" tax items of personal income tax, respectively. Due to the unavailability of the classification standard for business income from the National Bureau of Statistics, from a conservative perspective and in combination with the previous

definition of "business income," this article temporarily classifies the "labor remuneration income," "royalty income," "franchise use fee income," and "business income" of personal income tax as "business income (caliber 2)."

As shown in Table 1, an analysis of data from the China Tax Yearbook and the National Bureau of Statistics from 2018 to 2022 reveals that the maximum share of wage income in per capita disposable income of residents is 56.08%, and the minimum is 55.66%. The maximum share of business income in per capita disposable income of residents is 17.19%, and the minimum is 16.49%. Comparing the personal income tax shares of different incomes, during 2018-2022, the maximum share of wage and salary income in personal income tax is 67.26%, and the minimum is 59.14%. The maximum share of business income (caliber 1) in personal income tax revenue is 7.27%, and the minimum is 6.73%. The maximum share of business income (caliber 2) in personal income tax revenue is 11.4%, and the minimum is 10.17% (where the business income in 2018 is the total of individual business production and business income and the income from contracting and leasing enterprises and institutions).

Further analysis of the data shows that from the perspective of the tax base, the per capita disposable wage income of residents during 2018-2022 is about three times that of business income. From the perspective of tax amount, the tax on wage income is about 8 to 10 times that of business income (caliber 1) and 5 to 7 times that of business income (caliber 2). Therefore, it can be seen that the tax burden on wage income is much higher than that on business income, which is not in line with the principle of tax fairness.

Table 1. China's Personal Income Tax Revenue and Per Capita Disposable Income of Residents from 2018 to 2022

year	2018	2019	2020	2021	2022
Per capita disposable income of residents nationwide (yuan)	28,228.00	30,733.00	32,189.00	35,128.00	36,883.00
Per capita disposable wage income of residents (yuan)	15,829.00	17,186.00	17,917.00	19,629.00	20,590.00
Per capita disposable net business income of residents (yuan)	4,852.00	5,247.00	5,307.00	5,893.00	6,175.00
National personal income tax revenue (in ten thousand yuan)	138,719,678.00	103,885,286.00	117,325,024.00	141,453,178.00	151,407,321.00
Income from wages and salaries (in ten thousand yuan)	93,308,223.00	61,760,212.00	69,389,200.00	86,631,156.00	96,804,606.00
Income from remuneration for personal services (in ten thousand yuan)	6,251,929.00	4,152,971.00	3,965,949.00	4,482,873.00	4,693,597.00

thousand yuan)					
Income from business operations (Criterion 1, in ten thousand yuan)	9,342,318.00	7,303,209.00	8,531,173.00	10,011,891.00	10,513,573.00
Income from business operations (Criterion 2, in ten thousand yuan)	15,814,894.00	11,645,555.00	12,644,534.00	14,657,525.00	15,400,089.00
The proportion of wage income in per capita disposable income of residents	56.08%	55.92%	55.66%	55.88%	55.83%
The proportion of net business income in per capita disposable income of residents	17.19%	17.07%	16.49%	16.78%	16.74%
The proportion of tax revenue from wages and salaries in personal income tax revenue	67.26%	59.45%	59.14%	61.24%	63.94%
The proportion of tax revenue from business operations (Criterion 1) in personal income tax revenue	6.73%	7.03%	7.27%	7.08%	6.94%
The proportion of tax revenue from business operations (Criterion 2) in personal income tax revenue	11.40%	11.21%	10.78%	10.36%	10.17%

Data Sources: 1. The data related to individual income tax is sourced from the "China Tax Almanac" from 2019 to 2023.

2. The data on the per capita disposable income of residents nationwide is sourced from the official website of the National Bureau of Statistics.

4. Analysis of the Necessity of Implementing a Unified Taxation System for Labor Income

4.1 Principle of Tax Equity

The principle of tax equity encompasses both horizontal and vertical equity. Horizontal equity demands that taxpayers with the same income should pay the same amount of tax, while vertical equity implies that taxpayers with different incomes should pay different amounts of tax. In the current tax system, several categories of income derived from labor, excluding business income, have been incorporated into the comprehensive taxation system, subject to a seven-bracket progressive tax rate ranging from 3%

to 45%. On the other hand, business income falls under the category of classified taxation, subject to a five-bracket progressive tax rate ranging from 5% to 35%. From the perspective of the tax rate structure, there are significant differences between the two in terms of the number of brackets, the value of tax rates, and the tax rate differentials.

Moreover, under the current account-based taxation system for business income, costs, expenses, and losses can be deducted before taxation, potentially leading to a further reduction in the tax burden. Given that both are considered labor income, the previous analysis of tax burdens reveals that the tax burden on business income is lower than that on other forms of labor income. The principle of tax equity requires that taxpayers bear the same tax burden under identical or similar conditions. However, the disparities in tax burdens between business income and other forms of labor income under the current tax system violate the horizontal equity principle of taxation. For instance, taxpayers may opt for the lower tax burden method when it is difficult to distinguish between business income and income from labor remuneration, thereby leading to a loss of tax revenue.

4.2 Principle of Tax Efficiency

The current tax system only explicitly specifies a few categories of business income, such as income derived from personal engagement in "*educational, medical, and consulting*" activities and income from "personal contracting, leasing, subcontracting, and subleasing of enterprises and institutions." Other business activities are not clearly included in the scope of taxable business income. The vague boundaries of taxable business income make it difficult for taxpayers to determine the appropriate tax category when filing tax returns, thereby increasing compliance costs.

In terms of taxation methods, business income differs from other forms of income in that it does not have a withholding agent, requiring taxpayers to declare and pay taxes autonomously. In practice, taxpayers of business income primarily consist of individual business owners and personal partners in partnerships. Currently, there are two primary methods of taxation for business income: account-based taxation and presumptive taxation. Account-based taxation requires taxpayers to have a robust accounting system, which may not be available, prompting taxpayers to opt for presumptive taxation. The choice in taxation methods allows some taxpayers to abuse presumptive taxation policies, exploiting loopholes for tax avoidance or evasion. The principle of tax efficiency demands that the tax system be designed to be simplified and transparent, reducing both the tax collection costs for tax authorities and the compliance costs for taxpayers. The complex tax collection methods faced by taxpayers during the tax declaration process violate the principle of tax efficiency, hindering the regulatory function of personal income tax in income distribution and potentially leading to a loss of tax revenue.

5. Reform Directions for a Unified Taxation System for Labor Income

5.1 Clarifying Tax Boundaries

To incorporate business income into comprehensive income, it is essential to first clarify the tax boundaries of business income. Under the new tax collection and management model implemented in 2019, taxpayers often find it challenging to distinguish between income from labor remuneration and business income in practice. In response to this issue, the State Administration of Taxation proposed a substantive criterion for distinguishing between business income and income from labor remuneration for flexible workers, based on the "economic substance" of the services or business activities provided on the platform. However, the meaning of "economic substance" remains unclear. To integrate business income into the comprehensive taxation system, it is necessary to clarify the scope of taxable business income, improve tax laws and regulations, and define the boundaries of labor income.

5.2 Improving Tax Collection and Management Methods

The current account-based taxation model for business income imposes high standards on the accounting system, primarily affecting individual business owners and sole proprietorships. In actual tax collection processes, taxpayers often choose presumptive taxation over account-based taxation due to the flexibility it offers, despite its intended purpose of simplifying tax procedures and facilitating taxpayers. However, presumptive taxation often faces issues such as overly lenient tax assessment rates and lagging adjustment mechanisms, leading to imprecise reflections of taxpayers' actual business conditions. Many taxpayers of business income, especially individual business owners, commonly adopt presumptive taxation based on taxable income rates, which, while convenient, may indirectly reduce actual tax burdens. To advance the unified taxation of labor income, it is crucial to optimize and standardize the existing tax collection and management framework for business income. This includes abolishing or strictly limiting the scope of presumptive taxation, clearly defining the applicable boundaries of different taxation methods, and simplifying the conditions for account-based taxation to reduce taxpayers' compliance costs. These measures aim to incentivize taxpayers to comply with tax regulations more rigorously and cost-effectively, thereby promoting both tax equity and efficiency and ensuring the effective operation of the tax system.

5.3 Unifying Tax Rates and Deduction Standards for Labor Income

As previously mentioned, achieving unified taxation for labor income requires addressing the tax rate discrepancies in the current tax system. Firstly, business income, which is also considered labor income, is subject to a lower comprehensive tax rate than other forms of comprehensive income. Secondly, both comprehensive income and business income are taxed under a progressive tax rate system. If a taxpayer earns both business income and comprehensive income, their taxable income will be subject to different tax rates, potentially resulting in a lower overall tax burden due to the application of lower tax brackets for individual income categories compared to the combined income. This exacerbates tax inequity and undermines the role of personal income tax in regulating income disparities. Under the current account-based taxation model for business income, deductions for costs and expenses can lead

to even greater disparities in actual tax burdens. To achieve unified taxation for labor income, it is necessary to unify tax rates and deduction standards for labor income and related costs and expenses.

6. Conclusion and Outlook

As reforms deepen, the personal income tax system will become more sophisticated, providing stronger support for economic and social development. The development of the digital economy and the rise of flexible employment are diversifying the types of labor income. In response to the reform tasks outlined in the “*Decision*” regarding personal income tax, implementing a unified taxation system for labor income requires adapting to new developments and continuously improving relevant policies and systems to ensure tax equity and efficiency. In summary, a unified taxation system for labor income represents an important direction for personal income tax reform, requiring concerted efforts from all parties to drive the reform forward smoothly.

References

- Liao Yan. (2023). Research on including Business income in the comprehensive income of individual income Tax. *Chinese Academy of Fiscal Sciences*, 2023. <http://doi.org/10.26975/d.cnki.gccks.2023.000175>
- Xinyao, R. (2024). Taxation Models and Improvement Proposals for Personal Income Tax in the Sharing Economy. *Proceedings of Business and Economic Studies*, 7(3), 220-226.
- Liu, G., Liu, H., Liu, Y., et al. (2024). Personal income tax and corporate innovation: The key role of inventors' financial incentives. *Journal of Banking and Finance*, 164107203.
- Jon, B. (2024). The US Individual Income Tax: Recent Evolution and Evidence. *The Journal of Economic Perspectives*, 38(3), 33-60.
- Gambo, J. M. E., Liuraman, Z., Mshelia, H. A., et al. (2023). Effect of Internally Generated Revenue Strategy on Personal Income Tax Administration in Adamawa State, Nigeria. *Journal of Economics, Management and Trade*, 29(10), 59-66.